

AMENDED IN SENATE SEPTEMBER 8, 2003

AMENDED IN SENATE SEPTEMBER 2, 2003

AMENDED IN SENATE AUGUST 18, 2003

AMENDED IN SENATE JULY 16, 2003

AMENDED IN SENATE JULY 3, 2003

AMENDED IN ASSEMBLY MAY 19, 2003

AMENDED IN ASSEMBLY APRIL 10, 2003

CALIFORNIA LEGISLATURE—2003–04 REGULAR SESSION

## **ASSEMBLY BILL**

**No. 1601**

**Introduced by Assembly Member Frommer**  
(Principal coauthors: Senators Burton and Cedillo)

February 21, 2003

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An act to amend Sections 18628, 19116, 19164, 19166, 19173, 19177, 19179, 19504, 19715, and 21028 of, to add Section 18407 to, to add Chapter 9.5 (commencing with Section 19751) to Part 10.2 of, and to repeal and add Section 18648 of, the Revenue and Taxation Code, relating to taxation.

### LEGISLATIVE COUNSEL'S DIGEST

AB 1601, as amended, Frommer. Administration of taxes: tax shelters: penalties.

Existing law imposes various taxes and fees, and certain penalties on late payments of those taxes and fees. Existing law provides specified

conformity to federal income tax laws with respect to penalties imposed in connection with tax avoidance and abusive tax shelters.

This bill would, in modified conformity with federal income tax laws, increase the penalties imposed with respect to tax avoidance and abusive tax shelters, as provided.

This bill would require the Franchise Tax Board to develop and administer a voluntary compliance initiative, as specified, to be conducted during the period from January 1, 2004, to April 15, 2004, inclusive, and to apply to tax liabilities attributable to the use of abusive tax avoidance transactions, as specified, for taxable years beginning before January 1, 2003. This would generally authorize a taxpayer utilizing the voluntary compliance initiative to comply, with or without right to appeal, with the reporting and payment of taxes with respect to a previously filed tax return that used an abusive tax avoidance transaction to underreport tax liability. For a taxpayer who elects to comply without right to appeal, this bill would waive all penalties. For a taxpayer who elects to comply with right to appeal, this bill would waive only the new or increased penalties.

This bill would, except as provided, apply with respect to any penalty assessed on or after January 1, 2004, on any return for which the statute of limitations on assessment has not expired, and would otherwise apply on and after January 1, 2004.

This bill would require the Franchise Tax Board and the Legislative Analyst to report to the Legislature regarding the bill, as provided.

The bill would become operative only if SB 614 of the 2003–04 Regular Session is chaptered.

Vote: majority. Appropriation: no. Fiscal committee: yes. State-mandated local program: no.

*The people of the State of California do enact as follows:*

- 1 SECTION 1. Section 18407 is added to the Revenue and
- 2 Taxation Code, to read:
- 3 18407. Section 6011 of the Internal Revenue Code, relating to
- 4 general requirement of return, statement, or list, shall apply, except
- 5 as otherwise provided.
- 6 (a) Section 6011(a) of the Internal Revenue Code, relating to
- 7 general rule, is modified as follows:
- 8 (1) The phrase “any person liable for any tax imposed by Part
- 9 10 (commencing with Section 17001), Part 11 (commencing with



1 Section 23001) or this part,” shall be substituted for the phrase  
2 “when required by regulations prescribed by the Secretary any  
3 person made liable for any tax imposed by this title,” contained  
4 therein.

5 (2) “Secretary of the Treasury under Section 6011 of the  
6 Internal Revenue Code for federal income tax purposes or by the  
7 Franchise Tax Board” shall be substituted for “Secretary.”

8 (3) To additionally provide that “reportable transaction”  
9 includes any transaction of a type that the Secretary of the Treasury  
10 under Section 6011 of the Internal Revenue Code for federal  
11 income tax purposes or the Franchise Tax Board under this section  
12 for California income or franchise tax purposes determines as  
13 having a potential for tax avoidance or evasion including  
14 deductions, basis, credits, entity classification, dividend  
15 elimination, or omission of income, and shall be reported on the  
16 return or the statement required to be made.

17 (4) To additionally provide that “listed transaction” includes  
18 any transaction that is the same as, or substantially similar to, a  
19 transaction specifically identified by the Secretary of the Treasury  
20 under Section 6011 of the Internal Revenue Code for federal  
21 income tax purposes or by the Franchise Tax Board under this  
22 section for California income or franchise tax purposes, as a tax  
23 avoidance transaction including deductions, basis, credits, entity  
24 classification, dividend elimination, or omission of income and  
25 shall be reported on the return or statement required to be made.

26 (A) The Franchise Tax Board shall identify and publish “listed  
27 transactions” (whether identified by the Secretary of the Treasury  
28 under Section 6011 of the Internal Revenue Code for federal  
29 income tax purposes or by the Franchise Tax Board) through the  
30 use of Franchise Tax Board Notices or other published positions.  
31 In addition, the “listed transactions” identified and published  
32 pursuant to the preceding sentence shall be published on the Web  
33 site of the Franchise Tax Board.

34 (B) The Franchise Tax Board shall conduct a public outreach  
35 program to make taxpayers aware of the new and increased  
36 penalties associated with the use of tax avoidance transactions  
37 including deductions, basis, credits, entity classification, dividend  
38 elimination, or omission of income.

39 (5) Chapter 3.5 (commencing with Section 11340) of Part 1 of  
40 Division 3 of Title 2 of the Government Code does not apply to any

1 standard, criterion, procedure, determination, rule, notice, or  
2 guideline established or issued by the Franchise Tax Board  
3 pursuant to paragraph (4).

4 (b) Section 6011(b) of the Internal Revenue Code, relating to  
5 identification of taxpayer, does not apply and, in lieu thereof  
6 Section 18408 shall apply.

7 (c) Section 6011(c) of the Internal Revenue Code, relating to  
8 returns, etc., of DISCS and former DISCS and FSC's and former  
9 FSC's, does not apply.

10 (d) Section 6011(d) of the Internal Revenue Code, relating to  
11 authority to require information concerning Section 912  
12 allowances, does not apply.

13 (e) Section 6011(e) of the Internal Revenue Code, relating to  
14 regulations requiring returns on magnetic media, etc., shall take  
15 into account Section 18408 and shall also include the  
16 modifications made to Section 6011(e) of the Internal Revenue  
17 Code by Section 18408.

18 (f) Section 6011(f)(2) of the Internal Revenue Code, relating to  
19 incentives, does not apply.

20 SEC. 2. Section 18628 of the Revenue and Taxation Code is  
21 amended to read:

22 18628. (a) Section 6111 of the Internal Revenue Code,  
23 relating to registration of tax shelters, applies, except as otherwise  
24 provided.

25 (b) (1) Except as provided in subdivision (g), a tax shelter  
26 organizer is required to send a duplicate of the federal registration  
27 information, if applicable, or the same information required for  
28 federal tax shelters for California tax shelters to the Franchise Tax  
29 Board not later than the day on which the first offering for sale of  
30 interests in that tax shelter occurs.

31 (2) (A) The information provided to the Franchise Tax Board  
32 pursuant to paragraph (1) shall also include any other information  
33 required by a Franchise Tax Board Notice.

34 (B) Chapter 3.5 (commencing with Section 11340) of Part 1 of  
35 Division 3 of Title 2 of the Government Code does not apply to any  
36 additional information requested under this section.

37 (c) Any person required to register under Section 6111 of the  
38 Internal Revenue Code who receives a tax registration number  
39 from the Secretary of the Treasury shall, within 30 days after



1 request by the Franchise Tax Board, file a statement of that  
2 registration number.

3 (d) Section 6111(b) of the Internal Revenue Code, relating to  
4 inclusion of tax shelter identification numbers on returns, applies.

5 (e) Section 6111(c)(2)(A) of the Internal Revenue Code is  
6 amended by substituting the phrase “under subtitle A of the  
7 Internal Revenue Code or under this part, Part 10 (commencing  
8 with Section 17001), or Part 11 (commencing with Section 23001)  
9 of the Revenue and Taxation Code” for “under subtitle A.”

10 (f) (1) Section 6111(d) of the Internal Revenue Code is  
11 modified to further provide that, for purposes of this section and  
12 Section 18648, the term “tax shelter” includes any listed  
13 transaction (as defined under subdivision (a) of Section 18407).

14 (2) Section 6111(d)(1)(A) of the Internal Revenue Code is  
15 amended by substituting the phrase “avoidance or evasion of  
16 federal income tax or California income or franchise tax” for  
17 “avoidance or evasion of Federal income tax.”

18 (g) The registration requirements of this section apply to any  
19 tax shelter (within the meaning of Section 6111 of the Internal  
20 Revenue Code, as modified by this section) that additionally  
21 satisfies any of the following conditions:

22 (1) Organized in this state.

23 (2) Doing business in this state.

24 (3) Deriving income from sources in this state.

25 (4) At least one of its investors is a California taxpayer.

26 (h) In addition to the requirements set forth in subdivision (a),  
27 for any transactions entered into on or after February 28, 2000, that  
28 become listed transactions (as defined under ~~subdivision (a) of~~  
29 ~~Section 18407~~) *Section 6011(a) of the Internal Revenue Code*) at  
30 any time, those transactions shall be required to be registered with  
31 the Franchise Tax Board by the later of:

32 (1) Sixty days after entering into the transaction.

33 (2) Sixty days after the transaction becomes a listed  
34 transaction, or

35 (i) *In addition to the requirements set forth in subdivisions (a)*  
36 *and (h), for any transactions entered into on or after September 2,*  
37 *2003, that are specifically identified by the Franchise Tax Board*  
38 *for California income or franchise tax purposes (under the*  
39 *authority of paragraph (4) of subdivision (a) of Section 18407) as*  
40 *a “listed transaction” at any time those transactions shall be*

1 *required to be registered with the Franchise Tax Board by the later*  
2 *of:*

3 (1) *Sixty days after entering into the transaction.*

4 (2) *Sixty days after the transaction becomes a listed*  
5 *transaction.*

6 (3) *April 30, 2004.*

7 (3) *April 30, 2004.*

8 SEC. 3. Section 18648 of the Revenue and Taxation Code is  
9 repealed.

10 SEC. 4. Section 18648 is added to the Revenue and Taxation  
11 Code, to read:

12 18648. (a) Section 6112 of the Internal Revenue Code,  
13 relating to organizers and sellers of potentially abusive tax shelters  
14 that must keep lists of investors, applies, except as otherwise  
15 provided.

16 (b) Section 6112 of the Internal Revenue Code is modified by  
17 substituting the phrase “Secretary or the Franchise Tax Board” for  
18 the word “Secretary” each place it appears.

19 (c) The requirement to maintain lists under this section shall  
20 apply to any organizer, seller, or material advisor of a potentially  
21 abusive tax shelter (within the meaning of Section 6112 of the  
22 Internal Revenue Code, as modified by this section) that  
23 additionally satisfies any of the following conditions:

24 (1) Organized in this state.

25 (2) Doing business in this state.

26 (3) Deriving income from sources in this state.

27 (4) At least one of its investors is a California taxpayer.

28 (d) (1) Notwithstanding any regulation issued under Section  
29 6112 of the Internal Revenue Code, the list required to be  
30 maintained by this section for listed transactions, as defined in  
31 subdivision (a) Section 18407, shall be maintained in the form and  
32 manner prescribed by the Franchise Tax Board.

33 (2) Chapter 3.5 (commencing with Section 11340) of Part 1 of  
34 Division 3 of Title 2 of the Government Code does not apply to any  
35 requirement prescribed by the Franchise Tax Board under this  
36 section.

37 (3) For transactions entered into on or after February 28, 2000,  
38 that become listed transactions (as defined under ~~subdivision (a)~~  
39 ~~of Section 18407~~) *Section 6011(a) of the Internal Revenue Service*

1 at any time, the lists shall be provided to the Franchise Tax Board  
2 by the later of:

3 (A) Sixty days after entering into the transaction.

4 (B) Sixty days after the transaction becomes a listed  
5 transaction; or

6 (C) April 30, 2004.

7 (4) *For transactions entered into on or after September 2, 2003,*  
8 *that are specifically identified by the Franchise Tax Board of*  
9 *California income or franchise tax purposes (under the authority*  
10 *of paragraph (4) of subdivision (a) of Section 18407) as a “listed*  
11 *transaction” at any time, the list shall be provided to the Franchise*  
12 *Tax Board by the later of:*

13 (A) *Sixty days after entering into the transaction.*

14 (B) *Sixty days after the transaction becomes a listed*  
15 *transaction.*

16 (C) *April 30, 2004.*

17 (e) The terms “organizer,” “seller,” and “material advisor”  
18 mean a person that meets any of the requirements of this section  
19 or Section 6112 of the Internal Revenue Code or regulations issued  
20 thereunder.

21 SEC. 5. Section 19116 of the Revenue and Taxation Code is  
22 amended to read:

23 19116. (a) In the case of an individual who files a return of  
24 tax imposed under Part 10 (commencing with Section 17001) for  
25 a taxable year on or before the due date for the return, including  
26 extensions, if the Franchise Tax Board does not provide a notice  
27 to the taxpayer specifically stating the taxpayer’s liability and the  
28 basis of the liability before the close of the notification period, the  
29 Franchise Tax Board shall suspend the imposition of any interest,  
30 penalty, addition to tax, or additional amount with respect to any  
31 failure relating to the return which is computed by reference to the  
32 period of time the failure continues to exist and which is properly  
33 allocable to the suspension period.

34 (b) For purposes of this section:

35 (1) Except as provided in subdivision (e), “notification  
36 period” means the 18-month period beginning on the later of  
37 either of the following:

38 (A) The date on which the return is filed.

39 (B) The due date of the return without regard to extensions.



(2) “Suspension period” means the period beginning on the day after the close of the notification period and ending on the date which is 15 days after the date on which notice described in subdivision (a) is provided by the Franchise Tax Board.

(c) This section shall be applied separately with respect to each item or adjustment.

(d) This section shall not apply to any of the following:

(1) Any penalty imposed by Section 19131.

(2) Any penalty imposed by Section 19132.

(3) Any interest, penalty, addition to tax, or additional amount involving fraud.

(4) Any interest, penalty, addition to tax, or additional amount with respect to any tax liability shown on the return.

(5) Any criminal penalty.

(e) For taxpayers required by subdivision (a) of Section 18622 to report a change or correction by the Commissioner of Internal Revenue or other officer of the United States or other competent authority the following rules shall apply:

(1) The notification period under subdivision (a) shall be either of the following:

(A) One year from the date the notice required by Section 18622 is filed with the Franchise Tax Board by the taxpayer or the Internal Revenue Service, if the taxpayer or the Internal Revenue Service reports that change or correction within six months after the final federal determination.

(B) Two years from the date when the notice required by Section 18622 is filed with the Franchise Tax Board by the taxpayer or the Internal Revenue Service, if after the six-month period required in Section 18622, a taxpayer or the Internal Revenue Service reports a change or correction.

(2) The suspension period under subdivision (a) shall mean the period beginning on the day after the close of the notification period under paragraph (1) and ending on the date which is 15 days after the date on which notice described in subdivision (a) is provided by the Franchise Tax Board.

(f) For notices sent after January 1, 2004, this section does not apply to taxpayers with taxable income greater than two hundred thousand dollars (\$200,000) that have been contacted by the Franchise Tax Board regarding the use of a potentially abusive tax shelter (within the meaning of Section 19777).



(g) This section shall apply to taxable years ending after October 10, 1999.

SEC. 6. Section 19164 of the Revenue and Taxation Code is amended to read:

19164. (a) (1) An accuracy-related penalty shall be imposed under this part and shall be determined in accordance with Section 6662 of the Internal Revenue Code, relating to imposition of accuracy-related penalty, except as otherwise provided.

(2) With respect to corporations, this subdivision shall apply to all of the following:

(A) All taxable years beginning on or after January 1, 1990.

(B) Any other taxable year for which an assessment is made after July 16, 1991.

(C) For purposes of this section, references in Section 6662(e) of the Internal Revenue Code and the regulations thereunder, relating to treatment of an affiliated group that files a consolidated federal return, are modified to apply to those entities required to be included in a combined report under Section 25101 or 25110. For these purposes, entities included in a combined report pursuant to paragraph (4) or (6) of subdivision (a) of Section 25110 shall be considered only to the extent required to be included in the combined report.

(3) Section 6662(d)(1)(B) of the Internal Revenue Code is modified to provide that in the case of a corporation, other than an S corporation, that has been contacted by the Franchise Tax Board regarding the use of a potentially abusive tax shelter (within the meaning of Section 19777), there is a substantial understatement of tax for any taxable year if the amount of the understatement for the taxable year exceeds the lesser of:

(A) Ten percent of the tax required to be shown on the return for the taxable year (or, if greater, two thousand five hundred dollars (\$2,500)), or

(B) Five million dollars (\$5,000,000).

(4) Section 6662(d)(2)(A) of the Internal Revenue Code is modified to additionally provide that the excess determined under Section 6662(d)(2)(A) of the Internal Revenue Code shall be determined without regard to items to which Section 19773 applies and without regard to items with respect to which a penalty is imposed by Section 19774.

(5) For taxpayers that have been contacted by the Franchise Tax Board regarding the use of a potentially abusive tax shelter (within the meaning of Section 19777), Section 6662(d)(2)(B)(i) of the Internal Revenue Code is modified to substitute the phrase “the tax treatment of any item by the taxpayer if the taxpayer had reasonable belief that the tax treatment was more likely than not the proper treatment” for the phrase “the tax treatment of any item by the taxpayer if there is or was substantial authority for such treatment” contained therein.

(b) For purposes of Section 6662(d) of the Internal Revenue Code, Section 6664 of the Internal Revenue Code (as modified by subdivision (d)), Section 6694(a)(1) of the Internal Revenue Code, and this part, the Franchise Tax Board may prescribe a list of positions for which the Franchise Tax Board believes there is not substantial authority or there is no reasonable belief that the tax treatment is more likely than not the proper tax treatment. That list (and any revisions thereof) shall be published through the use of Franchise Tax Board Notices or other published positions. In addition, the “listed transactions” identified and published pursuant to the preceding sentence shall be published on the Web site of the Franchise Tax Board. This subdivision applies only to the list of positions relating to abusive tax shelters, within the meaning of Section 19777.

(c) A fraud penalty shall be imposed under this part and shall be determined in accordance with Section 6663 of the Internal Revenue Code, relating to imposition of fraud penalty, except as otherwise provided.

(d) Section 6664 of the Internal Revenue Code, relating to definitions and special rules, shall apply, except as otherwise provided.

(1) For taxpayers that have been contacted by the Franchise Tax Board regarding the use of a potentially abusive tax shelter (within the meaning of Section 19777), Section 6664 of the Internal Revenue Code is modified to additionally provide that no penalty shall be imposed under Section 19773 with respect to any portion of a reportable transaction understatement if it is shown that there was a reasonable cause for that portion and that the taxpayer acted in good faith with respect to that portion.

(2) Paragraph (1) does not apply to any reportable transaction understatement unless all of the following requirements are met:

1 (A) (i) The relevant facts affecting the tax treatment of the  
2 item are adequately disclosed in accordance with the regulations  
3 prescribed under Section 6011 of the Internal Revenue Code, as  
4 modified by Section 18407.

5 (ii) A taxpayer failing to adequately disclose in accordance  
6 with Section 6011 of the Internal Revenue Code, as modified by  
7 Section 18407, shall be treated as meeting the requirements of this  
8 subparagraph, if the penalty for that failure was rescinded under  
9 subdivision (e) of Section 19772.

10 (iii) For taxable years beginning on or before January 1, 2003,  
11 “adequately disclosed” includes the disclosure of the tax shelter  
12 identification number on the taxpayer’s return, as required by  
13 subdivision (c) of Section 18628.

14 (B) There is or was substantial authority for that treatment.

15 (C) The taxpayer reasonably believed that that treatment was  
16 more likely than not the proper treatment.

17 (3) For purposes of subparagraph (C) of paragraph (2) all of the  
18 following shall apply:

19 (A) A taxpayer shall be treated as having a reasonable belief  
20 with respect to the tax treatment of an item only if that belief meets  
21 both of the following requirements:

22 (i) Is based on the facts and law that exist at the time the return  
23 of tax that includes that tax treatment is filed.

24 (ii) Relates solely to the taxpayer’s chances of success on the  
25 merits of that treatment and does not take into account the  
26 possibility that the return will not be audited, that the treatment  
27 will not be raised on audit, or that the treatment will be resolved  
28 through settlement if it is raised.

29 (B) (i) An opinion of a tax advisor may not be relied upon to  
30 establish the reasonable belief of a taxpayer if either of the  
31 following conditions are met:

32 (I) The tax advisor is described in clause (ii).

33 (II) The opinion is described in clause (iii).

34 (ii) A tax advisor is described in this clause if the tax advisor  
35 meets any of the following conditions:

36 (I) Is a material advisor (within the meaning of subdivision (d)  
37 of Section 18648) who participates in the organization,  
38 management, promotion, or sale of the transaction or who is  
39 related (within the meaning of Sections 267(b) or 707(b)(1) of the  
40 Internal Revenue Code) to any person who so participates.

- 1 (II) Is compensated directly or indirectly by a material advisor  
2 with respect to the transaction.
- 3 (III) Has a fee arrangement with respect to the transaction that  
4 is contingent on all or part of the intended tax benefits from the  
5 transaction being sustained.
- 6 (IV) As determined under regulations prescribed by either the  
7 Secretary of the Treasury for federal income tax purposes or the  
8 Franchise Tax Board, has a continuing financial interest with  
9 respect to the transaction.
- 10 (iii) For purposes of clause (i), an opinion is disqualified if the  
11 opinion meets any of the following conditions:
- 12 (I) Is based on unreasonable, factual, or legal assumptions  
13 (including assumptions as to future events).
- 14 (II) Unreasonably relies on representations, statements,  
15 findings, or agreements of the taxpayer or any other person.
- 16 (III) Does not identify and consider all relevant facts.
- 17 (IV) Fails to meet any other requirement as either the Secretary  
18 of the Treasury for federal income tax purposes or the Franchise  
19 Tax Board may by forms and instructions prescribe.
- 20 (e) Section 6665 of the Internal Revenue Code, relating to  
21 applicable rules, shall apply, except as otherwise provided.
- 22 (f) For taxpayers that have been contacted by the Franchise Tax  
23 Board regarding the use of a potentially abusive tax shelter (within  
24 the meaning of Section 19777), Section 461(i)(3)(C) of the  
25 Internal Revenue Code is modified by substituting a reference to  
26 “Section 1274(b)(3)(B) of the Internal Revenue Code, as  
27 modified by subdivision (g) of Section 19164” instead of the  
28 reference to “Section 6662(d)(2)(C)(iii)” contained therein.
- 29 (g) For taxpayers that have been contacted by the Franchise Tax  
30 Board regarding the use of a potentially abusive tax shelter (within  
31 the meaning of Section 19777), Section 1274(b)(3)(B)(i) of the  
32 Internal Revenue Code is modified to provide that for purposes of  
33 Section 1274(b)(3)(B) of the Internal Revenue Code, the term  
34 “tax shelter” means (1) a partnership or other entity, (2) any  
35 investment plan or arrangement, or (3) any other plan or  
36 arrangement, if a significant purpose of the partnership, entity,  
37 plan, or arrangement is the avoidance or evasion of federal income  
38 tax or the tax imposed under Part 10 (commencing with Section  
39 17001) or Part 11 (commencing with Section 23001).



SEC. 7. Section 19166 of the Revenue and Taxation Code is amended to read:

19166. A penalty shall be imposed for understatement of any taxpayer's liability by a tax return preparer. The penalty shall be determined in accordance with Section 6694 of the Internal Revenue Code, except as otherwise provided.

(a) (1) For taxpayers that have been contacted by the Franchise Tax Board regarding the use of a potentially abusive tax shelter (within the meaning of Section 19777), Section 6694(a) of the Internal Revenue Code is modified to substitute "one thousand dollars (\$1,000)" for "two hundred fifty dollars (\$250)."

(2) Section 6694(a)(1) of the Internal Revenue Code is modified to substitute the phrase "reasonable belief that the tax treatment in that position was more likely than not the proper treatment" instead of the phrase "realistic possibility of being sustained on its merits" contained therein.

(3) Section 6694(a)(3) of the Internal Revenue Code is modified to substitute the phrase "or there was no reasonable basis for the tax treatment of that position" instead of the phrase "or was frivolous" contained therein.

(b) Section 6694(b) of the Internal Revenue Code is modified to substitute "\$5,000" for "\$1,000."

(c) Section 6694(c) of the Internal Revenue Code shall not apply and, in lieu thereof, the following shall apply:

(1) If, within 30 days after the day on which notice and demand of any penalty under Section 6694(a) or 6694(b) of the Internal Revenue Code is made against any person who is an income tax return preparer, that person pays an amount which is not less than 15 percent of the amount of that penalty and files a claim for refund of the amount so paid, no levy or proceeding in court for the collection of the remainder of that penalty shall be made, begun, or prosecuted until the final resolution of a proceeding begun as provided in paragraph (2). Notwithstanding Section 19381, the beginning of that proceeding or levy during the time that prohibition is in force may be enjoined in a proceeding in the superior court.

(2) If, within 30 days after the day on which a claim for refund of any partial payment of any penalty under Section 6694(a) or 6694(b) of the Internal Revenue Code is denied (or, if earlier, within 30 days after the expiration of six months after the day on

1 which the claim for refund has been filed), the income tax return  
2 preparer fails to begin a proceeding in the superior court for the  
3 determination of his or her liability for that penalty, paragraph (1)  
4 shall cease to apply with respect to that penalty, effective on the  
5 day following the close of the applicable 30-day period referred to  
6 in this subdivision.

7 (3) The running of the period of limitations provided in Section  
8 19371 on the collection by levy or by a proceeding in court in  
9 respect of any penalty described in paragraph (1) shall be  
10 suspended for the period during which the Franchise Tax Board is  
11 prohibited from collecting by levy or a proceeding in court.

12 SEC. 8. Section 19173 of the Revenue and Taxation Code is  
13 amended to read:

14 19173. (a) (1) Any person required to register under Section  
15 18628 or maintain and provide a list under Section 18648, for any  
16 calendar year, is liable for a penalty as determined under  
17 subdivision (b) if that person does any of the following:

18 (A) (i) Fails to register under Section 18628 on or before the  
19 date prescribed therefor.

20 (ii) For reportable transactions (as defined under Section  
21 18407), fails to furnish the list within 20 days of a request.

22 (iii) For listed transactions, fails to provide the list on or before  
23 the date prescribed therefor in Section 18648.

24 (B) Registers a tax shelter or provides a list which fails to show  
25 the information required under Section 18628 or Section 18648.

26 (C) Fails to furnish the required statement to each investor.

27 (2) Paragraph (1) of this subdivision does not apply if it is  
28 shown that subdivision (d) applies or that the information required  
29 under paragraph (2) of ~~subdivision (a)~~ *subdivision (b)* of Section  
30 18628 was not identified in a Franchise Tax Board Notice issued  
31 prior to the date the transaction or shelter was entered into.

32 (b) (1) (A) For purposes of subdivision (a), the amount  
33 determined under this subdivision for a tax shelter required to be  
34 registered under Section 18628 is, except as provided in  
35 subparagraph (B), fifteen thousand dollars (\$15,000).

36 (B) If the penalty is with respect to a listed transaction (as  
37 defined under Section 18407), the amount determined under this  
38 subdivision for a tax shelter required to be registered under Section  
39 18628 shall be the greater of:

40 (i) One hundred thousand dollars (\$100,000).

1 (ii) Fifty percent of the gross income that the organizer or  
2 material advisor derived from that activity.

3 (C) In the case of intentional disregard by an organizer or  
4 material advisor of the requirement to maintain and provide  
5 information regarding a listed transaction (as defined under  
6 Section 18407) the percentage of gross income under clause (ii) of  
7 subparagraph (B) is “75 percent” instead of “50 percent.”

8 (2) For purposes of subdivision (a), the amount determined  
9 under this subdivision for the failure to provide a list required to  
10 be maintained under Section 18648 is as follows:

11 (A) For reportable transactions, the penalty amount shall be ten  
12 thousand dollars (\$10,000) for each day after the 20th day that the  
13 organizer or material advisor has failed to make the list available  
14 to the Franchise Tax Board after written request for that list was  
15 made by the Franchise Tax Board.

16 (B) For listed transactions, the penalty amount shall be  
17 determined under subparagraph (B) of paragraph (1).

18 (c) The penalty imposed by subdivision (a) shall be assessed  
19 against the person required to file a copy of the federal registration  
20 or required to register under Section 18628, or the person required  
21 to maintain or provide a list under Section 18648. The penalty may  
22 be assessed at any time during the period ending eight years after  
23 the failure has occurred.

24 (d) (1) The Chief Counsel of the Franchise Tax Board may  
25 rescind all or any portion of any penalty imposed by subdivision  
26 (a) with respect to any violation with respect to a tax shelter  
27 required to be registered under Section 18628, or a list required to  
28 be maintained or provided under Section 18648, if all of the  
29 following apply:

30 (A) The violation is with respect to a reportable transaction,  
31 other than a listed transaction (as defined under subdivision (a) of  
32 Section 18407).

33 (B) The person on whom the penalty is imposed has a history  
34 of complying with the requirements of this part and Part 10  
35 (commencing with Section 17001) or Part 11 (commencing with  
36 Section 23001).

37 (C) It is shown that the violation is due to an unintentional  
38 mistake of fact.

39 (D) Imposing the penalty would be against equity and good  
40 conscience.



1 (E) Rescinding the penalty would promote compliance with the  
2 requirements of this part and Part 10 (commencing with Section  
3 17001) or Part 11 (commencing with Section 23001) and effective  
4 tax administration.

5 (2) The exercise of authority under paragraph (1) shall be at the  
6 sole discretion of the Chief Counsel of the Franchise Tax Board  
7 and may not be delegated.

8 (3) Notwithstanding any other law or rule of law, any  
9 determination under this subdivision may not be reviewed in any  
10 administrative or judicial proceeding.

11 (e) Article 3 (commencing with Section 19031) of this chapter  
12 (relating to deficiency assessments) shall not apply with respect to  
13 the assessment or collection of any penalty imposed by  
14 subdivision (a).

15 (f) The penalty imposed by this section is in addition to any  
16 penalty imposed under Part 10 (commencing with Section 17001),  
17 Part 11 (commencing with Section 23001), or this part.

18 SEC. 9. Section 19177 of the Revenue and Taxation Code is  
19 amended to read:

20 19177. (a) A penalty shall be imposed for promoting abusive  
21 tax shelters. The penalty shall be determined in accordance with  
22 the provisions of Section 6700 of the Internal Revenue Code,  
23 except as otherwise provided.

24 (b) Notwithstanding Section 6700(a) of the Internal Revenue  
25 Code, if an activity with respect to which a penalty imposed under  
26 Section 6700(a) of the Internal Revenue Code involves a statement  
27 described in Section 6700(a)(2)(A) of the Internal Revenue Code,  
28 the amount of the penalty imposed under subdivision (a) shall be  
29 equal to 50 percent of the gross income derived (or to be derived)  
30 from that activity by the person on which the penalty is imposed.

31 SEC. 10. Section 19179 of the Revenue and Taxation Code is  
32 amended to read:

33 19179. A penalty shall be imposed for filing a frivolous  
34 return. The penalty shall be determined in accordance with Section  
35 6702 of the Internal Revenue Code, except as otherwise provided.

36 (a) Section 6702 of the Internal Revenue Code shall be applied  
37 to returns required to be filed under this part.

38 (b) For taxpayers that have been contacted by the Franchise Tax  
39 Board regarding the use of a potentially abusive tax shelter (within

1 the meaning of Section 19777), Section 6702(a) of the Internal  
2 Revenue Code is modified as follows:

3 (1) By substituting “\$5,000” instead of “\$500.”

4 (2) By substituting the phrase “person” instead of the phrase  
5 “individual” in each place that it appears.

6 (3) By substituting “tax imposed under Part 10 (commencing  
7 with Section 17001), Part 11 (commencing with Section 23001)  
8 or this part” instead of the phrase “tax imposed by subtitle A”  
9 contained therein.

10 (4) By substituting the phrase “is based on” instead of the  
11 phrase “is due to” contained therein.

12 (5) By substituting the phrase “frivolous or is based on a  
13 position that the Franchise Tax Board has identified as frivolous  
14 under subdivision (c) of Section 19179” instead of the phrase  
15 “frivolous” contained therein.

16 (6) By substituting the phrase “reflects a desire to delay or  
17 impede the administration of federal income tax laws as  
18 determined by the Secretary of the Treasury or the administration  
19 of the tax imposed under Part 10 (commencing with Section  
20 17001), Part 11 (commencing with Section 23001) or this part as  
21 determined by the Franchise Tax Board” instead of the phrase “a  
22 desire (which appears on the purported return) to delay or impede  
23 the administration of Federal income tax laws” contained therein.

24 (c) (1) The Franchise Tax Board shall prescribe (and  
25 periodically revise) a list of positions which the Secretary of the  
26 Treasury for federal income tax purposes or the Franchise Tax  
27 Board has identified as being frivolous for purposes of this section.

28 (2) Chapter 3.5 (commencing with Section 11340) of Part 1 of  
29 Division 3 of Title 2 of the Government Code does not apply to any  
30 standard, criterion, procedure, determination, rule, notice, or  
31 guideline established or prescribed by the Franchise Tax Board  
32 pursuant to paragraph (1).

33 (d) (1) Except as provided in paragraph (3), any person who  
34 submits a specified frivolous submission shall pay a penalty of five  
35 thousand dollars (\$5,000).

36 (2) For purposes of this section, all of the following shall apply:

37 (A) The term “specified frivolous submission” means a  
38 specified submission if any portion of that submission meets any  
39 of the following conditions:

1 (i) Is based on a position which the Franchise Tax Board has  
2 identified as frivolous under subdivision (c).

3 (ii) Reflects a desire to delay or impede the administration of  
4 federal income tax laws as determined by the Secretary of the  
5 Treasury or the administration of the tax imposed under Part 10  
6 (commencing with Section 17001), Part 11 (commencing with  
7 Section 23001) or this part as determined by the Franchise Tax  
8 Board.

9 (B) The term “specified submission” means any of the  
10 following:

11 (i) A protest under Section 19041.

12 (ii) A request for a hearing under Section 19044.

13 (iii) An application under any of the following sections:

14 (I) Section 19008 (relating to agreements for payment of tax  
15 liability in installments).

16 (II) Section 19443 (relating to compromises).

17 (III) Section 21004 (relating to actions of the Taxpayer Right’s  
18 Advocate).

19 (3) If the Franchise Tax Board provides a person with notice  
20 that a submission is a specified frivolous submission and the  
21 person withdraws that submission within 30 days after the notice,  
22 the penalty imposed under paragraph (1) does not apply with  
23 respect to that submission.

24 (e) (1) The Chief Counsel of the Franchise Tax Board may  
25 rescind all or any portion of any penalty imposed by this section  
26 if both of the following apply:

27 (A) Imposing the penalty would be against equity and good  
28 conscience.

29 (B) Rescinding the penalty would promote compliance with  
30 the requirements of this part and Part 10 (commencing with  
31 Section 17001) or Part 11 (commencing with Section 23001) and  
32 effective tax administration.

33 (2) The exercise of authority under paragraph (1) shall be at the  
34 sole discretion of the Chief Counsel of the Franchise Tax Board  
35 and may not be delegated.

36 (3) Notwithstanding any other law or rule of law, any  
37 determination under this subdivision may not be reviewed in any  
38 administrative or judicial proceeding.

39 (f) The penalties imposed by this section shall be in addition to  
40 any other penalty provided by law.

1 SEC. 11. Section 19504 of the Revenue and Taxation Code is  
2 amended to read:

3 19504. (a) The Franchise Tax Board, for the purpose of  
4 administering its duties under this part, including ascertaining the  
5 correctness of any return; making a return where none has been  
6 made; determining or collecting the liability of any person in  
7 respect of any liability imposed by Part 10 (commencing with  
8 Section 17001), Part 11 (commencing with Section 23001), or this  
9 part (or the liability at law or in equity of any transferee in respect  
10 of that liability); shall have the power to require by demand, that  
11 an entity of any kind including, but not limited to, employers,  
12 persons, or financial institutions provide information or make  
13 available for examination or copying at a specified time and place,  
14 or both, any book, papers, or other data which may be relevant to  
15 that purpose. Any demand to a financial institution shall comply  
16 with the California Right to Financial Privacy Act set forth in  
17 Chapter 20 (commencing with Section 7460) of Division 7 of Title  
18 1 of the Government Code. Information that may be required upon  
19 demand includes, but is not limited to, any of the following:

20 (1) Addresses and telephone numbers of persons designated by  
21 the Franchise Tax Board.

22 (2) Information contained on Federal Form W-2 (Wage and  
23 Tax Statement), Federal Form W-4 (Employee's Withholding  
24 Allowance Certificate), or State Form DE-4 (Employee's  
25 Withholding Allowance Certificate).

26 (b) The Franchise Tax Board may require the attendance of the  
27 taxpayer or of any other person having knowledge in the premises  
28 and may take testimony and require material proof for its  
29 information and administer oaths to carry out this part.

30 (c) (1) The Franchise Tax Board may issue subpoenas or  
31 subpoenas duces tecum, which subpoenas must be signed by any  
32 member of the Franchise Tax Board and may be served on any  
33 person for any purpose.

34 (2) For taxpayers that have been contacted by the Franchise Tax  
35 Board regarding the use of a potentially abusive tax shelter (within  
36 the meaning of Section 19777), the subpoena may be signed by any  
37 member of the Franchise Tax Board, the Executive Officer of the  
38 Franchise Tax Board, or any designee.

39 (d) Obedience to subpoenas or subpoenas duces tecum issued  
40 in accordance with this section may be enforced by application to

1 the superior court as set forth in Article 2 (commencing with  
2 Section 11180) of Chapter 2 of Part 1 of Division 3 of Title 2 of  
3 the Government Code.

4 (e) When examining a return, the Franchise Tax Board shall not  
5 use financial status or economic reality examination techniques to  
6 determine the existence of unreported income of any taxpayer  
7 unless the Franchise Tax Board has a reasonable indication that  
8 there is a likelihood of unreported income. This subdivision  
9 applies to any examination beginning on or after October 10, 1999.

10 SEC. 12. Section 19715 of the Revenue and Taxation Code is  
11 amended to read:

12 19715. (a) A civil action in the name of the State of California  
13 to enjoin any person from further engaging in specified conduct  
14 may be commenced at the request of the Franchise Tax Board. Any  
15 action under this section shall be brought in accordance with  
16 Section 19707. The court may exercise its jurisdiction over that  
17 action separate and apart from any other action brought by the  
18 State of California against that person.

19 (b) In any action under subdivision (a), the court may enjoin the  
20 person from engaging in the specified conduct or in any other  
21 activity subject to penalty under this part, if the court finds both of  
22 the following:

23 (1) That the person has engaged in any specified conduct.

24 (2) That injunctive relief is appropriate to prevent recurrence  
25 of that specified conduct.

26 (c) For purposes of this section, the term “specified conduct”  
27 means any action, or failure to take action, subject to penalty under  
28 Section 19173, 19174, 19177, or 19178.

29 SEC. 13. Chapter 9.5 (commencing with Section 19751) is  
30 added to Part 10.2 of Division 2 of the Revenue and Taxation Code,  
31 to read:

32  
33 CHAPTER 9.5. TAX SHELTERS  
34

35 19751. (a) The Franchise Tax Board shall develop and  
36 administer a voluntary compliance initiative for taxpayers subject  
37 to Part 10 (commencing with Section 17001) and Part 11  
38 (commencing with Section 23001), as provided in this chapter.

39 (b) The voluntary compliance initiative shall be conducted  
40 during the period from January 1, 2004, to April 15, 2004,

1 inclusive, pursuant to Section 19754. This initiative shall apply to  
2 tax liabilities attributable to the use of abusive tax avoidance  
3 transactions for taxable years beginning before January 1, 2003.

4 (c) The Franchise Tax Board shall issue forms and instructions  
5 and may take any other actions necessary, including the use of  
6 closing agreements, to implement this chapter.

7 (d) The Franchise Tax Board shall publicize the voluntary  
8 compliance initiative so as to maximize public awareness of and  
9 participation in the initiative. The Franchise Tax Board shall  
10 coordinate to the highest degree possible its publicity efforts and  
11 other actions taken in implementing this chapter.

12 (e) Any correspondence mailed by the Franchise Tax Board to  
13 a taxpayer at the taxpayer's last known address outlining the  
14 voluntary compliance initiative under this chapter constitutes  
15 "contact" within the meaning of Treasury Regulation Section  
16 1.6664-2(c)(3), relating to qualified amended returns, and  
17 paragraph (3) of subdivision (e) of Section 19773 and Section  
18 19777, regarding increased interest rate.

19 19752. Any taxpayer who meets the requirements of Section  
20 19754 may elect the application of either, but not both, of the  
21 following:

22 (a) Voluntary compliance without appeal. If this option is  
23 elected, then each of the following shall apply:

24 (1) The Franchise Tax Board shall waive or abate all penalties  
25 imposed by this part, for all taxable years where the taxpayer elects  
26 to participate in the initiative, as a result of the underreporting of  
27 tax liabilities attributable to the use of abusive tax avoidance  
28 transactions.

29 (2) Except as provided in Section 19753, no criminal action  
30 shall be brought against the taxpayer for the taxable years with  
31 respect to issues for which the taxpayer voluntarily complies under  
32 this chapter.

33 (3) No penalty may be waived or abated under this chapter if  
34 the penalty imposed is attributable to an assessment of taxes that  
35 became final prior to December 31, 2003.

36 (4) Notwithstanding Chapter 6 (commencing with Section  
37 19301) of this part, the taxpayer may not file a claim for refund for  
38 the amounts paid in connection with abusive tax avoidance  
39 transactions under this chapter.

(b) Voluntary compliance with appeal. If this option is elected, then each of the following shall apply:

(1) The Franchise Tax Board shall waive or abate all penalties, except the accuracy-related penalty under Section 19164 (as in effect immediately before enactment of the act adding this section), imposed by this part, for each of the taxable years for which the taxpayer elects to participate in the initiative, that are owed as a result of the underreporting of tax liabilities attributable to the use of abusive tax avoidance transactions.

(2) Except as provided in Section 19753, no criminal action may be brought against the taxpayer for each of the taxable years for which the taxpayer voluntarily complies under this section.

(3) No penalty may be waived under this chapter if the penalty imposed is attributable to an assessment of taxes that became due and payable prior to December 31, 2003.

(4) The taxpayer may file a claim for refund under Chapter 6 (commencing with Section 19301) of this part. Notwithstanding Section 19331, the taxpayer may not file an appeal to the board until after either of the following:

(A) The date the Franchise Tax Board takes action on the claim for refund for the tax year to which this chapter applies.

(B) The later of either of the following dates:

(i) The date that is 180 days after the date of a final determination by the Internal Revenue Service with respect to the transaction or transactions to which this chapter applies.

(ii) The date that is four years after the date the claim for refund was filed or one year after full payment of all tax, including penalty and interest was made, whichever date is later.

(5) The taxpayer shall be subject to the accuracy-related penalty under Section 19164.

(A) The penalty may be assessed:

(i) When the Franchise Tax Board takes action on the claim for refund.

(ii) When a federal determination becomes final for the same issue, in which case the penalty shall be assessed (and may not be abated) if the penalty was assessed at the federal level.

(B) In determining the amount of the underpayment of tax, Treasury Regulation Section 1.6664-2(c)(2), as promulgated under Section 6664 of the Internal Revenue Code, relating to qualified amended returns, shall not apply. The amount of the



underpayment is the difference between the amount of tax shown on the original return and the correct amount of tax for the taxable year. The underpayment amount shall not be less than the amount of the claim for refund filed by the taxpayer under paragraph (4) that was denied.

(C) The penalty is due and payable upon notice and demand pursuant to Section 19049. Only after the taxpayer has paid all amounts due, including the penalty, and the claim is denied in whole or in part, may the taxpayer file an appeal under Chapter 6 (commencing with Section 19301), of this part in conjunction with the appeal filed under paragraph (4).

(c) A taxpayer's election under this section shall be made for all taxable years of the taxpayer governed by this chapter. A separate election for each taxable year governed by this chapter is not allowed.

19753. (a) This chapter does not apply to violations of this part for which, as of December 31, 2003, any of the following applies:

(1) A criminal complaint was filed against the taxpayer in connection with an abusive tax avoidance transaction or transactions.

(2) The taxpayer is the subject of a criminal investigation in connection with an abusive tax avoidance transaction or transactions.

(b) No refund or credit shall be granted with respect to any penalty paid prior to the time the taxpayer participates in the voluntary compliance initiative authorized by this chapter.

(c) For purposes of this chapter, an "abusive tax avoidance transaction" means a plan or arrangement devised for the principal purpose of avoiding tax. Abusive tax avoidance transactions include, but are not limited to, "listed transactions" as described in subdivision (a) of Section 18407.

19754. (a) The voluntary compliance initiative described in this chapter applies to any taxpayer who was not eligible to participate in the Internal Revenue Service's Offshore Voluntary Compliance Initiative described in Revenue Procedure 2003-11, and during the period from January 1, 2004, to April 15, 2004, does both of the following:

(1) Files an amended tax return under this part for each taxable year for which the taxpayer has previously filed a tax return using

1 an abusive tax avoidance transaction to underreport the taxpayer's  
2 tax liability for that taxable year. Each amended return shall report  
3 all income from all sources, without regard to the abusive tax  
4 avoidance transaction.

5 (2) Except as provided in subdivision (b), pays in full all taxes  
6 and interest due.

7 (b) The Franchise Tax Board may enter into an installment  
8 payment agreement in lieu of the full payment required under  
9 paragraph (2) of subdivision (a). Any installment payment  
10 agreement authorized by this subdivision shall include interest on  
11 the unpaid amount at the rate prescribed in Section 19521. Failure  
12 by the taxpayer to fully comply with the terms of the installment  
13 payment agreement shall render the waiver of penalties null and  
14 void, and the total amount of tax, interest, and all penalties shall  
15 be immediately due and payable.

16 (c) After April 15, 2004, the Franchise Tax Board may issue a  
17 deficiency assessment upon an amended return filed pursuant to  
18 subdivision (a), impose penalties, or initiate criminal action under  
19 this part with respect to the difference between the amount shown  
20 on that return and the correct amount of tax. This action shall not  
21 invalidate any waivers granted under Section 19752.

22 (d) In addition to any other authority to examine returns, for the  
23 purpose of improving state tax administration, the Franchise Tax  
24 Board may inquire into the facts and circumstances related to the  
25 use of abusive tax avoidance transactions to underreport the tax  
26 liabilities for which a taxpayer has participated in the voluntary  
27 compliance initiative under this chapter. Taxpayers shall cooperate  
28 fully with inquiries described in this subdivision. Failure by a  
29 taxpayer to fully cooperate in an inquiry described in this  
30 subdivision shall render the waiver of penalties under this chapter  
31 null and void and the taxpayer may be assessed any penalties that  
32 may apply.

33 19755. (a) Notwithstanding Section 19057, with respect to  
34 proposed deficiency assessments related to an abusive tax  
35 avoidance transaction, as defined in subdivision (c) of Section  
36 19753, a notice of a proposed deficiency assessment may be  
37 mailed to the taxpayer within eight years after the return was filed,  
38 or within the period otherwise provided in Article 3 (commencing  
39 with Section 19031) of Chapter 4 of this part, whichever expires  
40 later.

(b) This section shall apply to any return filed under this part on or after January 1, 2000.

19772. (a) Any large entity or high net worth individual who fails to include on any return or statement any information with respect to a reportable transaction that is required under Section 6011 of the Internal Revenue Code, as modified by Section 18407, to be included with that return or statement shall pay a penalty for each omission in the amount determined under subdivision (b).

(b) (1) Except as provided in paragraph (2), the amount of the penalty under subdivision (a) shall be fifteen thousand dollars (\$15,000).

(2) The amount of the penalty under subdivision (a) with respect to a listed transaction shall be thirty thousand dollars (\$30,000).

(c) For purposes of this section:

(1) The term “high net worth individual” means, with respect to a transaction, an individual whose net worth exceeds two million dollars (\$2,000,000) immediately before the transaction.

(2) The term “large entity” means, with respect to any taxable year, a person (other than an individual) with gross receipts in excess of ten million dollars (\$10,000,000) for either the taxable year in which the reportable transaction occurs or in the preceding taxable year. Rules similar to the rules of Section 448(c)(2) and 448(c)(3) of the Internal Revenue Code, other than Section 448(c)(3)(A) of the Internal Revenue Code, shall apply for purposes of this paragraph.

(d) For purposes of this section:

(1) The term “reportable transaction” means any transaction with respect to which information is required to be included with a return or statement because, as determined under regulations prescribed by the Secretary of the Treasury under Section 6011 of the Internal Revenue Code for federal income tax purposes or by the Franchise Tax Board under Section 18407, that transaction is of a type that the Secretary of the Treasury for federal income tax purposes or the Franchise Tax Board determines as having a potential for tax avoidance or evasion.

(2) Except as provided in regulations prescribed by the Secretary of the Treasury or by the Franchise Tax Board, the term “listed transaction” means a reportable transaction (as defined in paragraph (1)) that is the same as, or substantially similar to, a

1 transaction specifically identified by the Secretary of the Treasury  
2 for purposes of Section 6011 of the Internal Revenue Code for  
3 federal income tax purposes or by the Franchise Tax Board for  
4 purposes of Section 6011 of the Internal Revenue Code or Section  
5 18407, as a tax avoidance transaction.

6 (e) (1) The Chief Counsel of the Franchise Tax Board may  
7 rescind all or any portion of any penalty imposed by this section  
8 with respect to any violation if all of the following apply:

9 (A) The violation is with respect to a reportable transaction  
10 other than a listed transaction.

11 (B) The person on whom the penalty is imposed has a history  
12 of complying with the requirements of this part and Part 10  
13 (commencing with Section 17001) or Part 11 (commencing with  
14 Section 23001).

15 (C) It is shown that the violation is due to an unintentional  
16 mistake of fact.

17 (D) Imposing the penalty would be against equity and good  
18 conscience.

19 (E) Rescinding the penalty would promote compliance with the  
20 requirements of this part and Part 10 (commencing with Section  
21 17001) or Part 11 (commencing with Section 23001) and effective  
22 tax administration.

23 (2) The exercise of authority under paragraph (1) shall be at the  
24 sole discretion of the Chief Counsel of the Franchise Tax Board  
25 and may not be delegated.

26 (3) Notwithstanding any other law or rule of law, any  
27 determination under this subdivision may not be reviewed in any  
28 administrative or judicial proceeding.

29 (f) Article 3 (commencing with Section 19031) of Chapter 4  
30 (relating to deficiency assessments) shall not apply with respect to  
31 the assessment or collection of any penalty imposed under this  
32 section.

33 (g) The penalty imposed by this section is in addition to any  
34 penalty imposed under Part 10 (commencing with Section 17001),  
35 Part 11 (commencing with Section 23001), or this part.

36 19773. (a) If a taxpayer has a reportable transaction  
37 understatement for any taxable year, there shall be added to the tax  
38 an amount equal to 20 percent of the amount of that  
39 understatement.

1 (b) For purposes of this section, both of the following shall  
2 apply:

3 (1) The term “reportable transaction understatement” means  
4 the sum of subparagraphs (A) and (B).

5 (A) The product of:

6 (i) The amount of the increase (if any) in taxable income which  
7 results from a difference between the proper tax treatment of an  
8 item to which this section applies and the taxpayer’s treatment of  
9 that item (as shown on the taxpayer’s return of tax).

10 (ii) The highest rate of tax imposed on the taxpayer under Part  
11 10 (commencing with Section 17001) in the case of a taxpayer  
12 subject to tax under that part or under Part 11 (commencing with  
13 Section 23001) in the case of a taxpayer that is subject to tax under  
14 that part.

15 (B) The amount of the decrease (if any) in the aggregate  
16 amount of credits determined under Part 10 (commencing with  
17 Section 17001) or Part 11 (commencing with Section 23001), as  
18 applicable, that results from a difference between the taxpayer’s  
19 treatment of an item to which this section applies (as shown on the  
20 taxpayer’s return of tax) and the proper tax treatment of that item.

21 (C) For purposes of subparagraph (A), any reduction of the  
22 excess of deductions allowed for the taxable year over gross  
23 income for that year, and any reduction in the amount of capital  
24 losses which would (without regard to Section 1211 of the Internal  
25 Revenue Code) be allowed for that year, shall be treated as an  
26 increase in taxable income.

27 (2) This section shall apply to any item that is attributable to  
28 either of the following:

29 (A) Any listed transaction.

30 (B) Any reportable transaction (other than a listed transaction)  
31 if a significant purpose of that transaction is the avoidance or  
32 evasion of tax imposed under Part 10 (commencing with Section  
33 17001) or Part 11 (commencing with Section 23001).

34 (c) (1) Subdivision (a) shall be applied by substituting “30  
35 percent” for “20 percent” with respect to the portion of any  
36 reportable transaction understatement with respect to which the  
37 requirement of Section 6664 of the Internal Revenue Code, as  
38 modified by subparagraph (A) of paragraph (2) of subdivision (d)  
39 of Section 19164, is not met.

1 (2) (A) If the notice of proposed assessment of additional tax  
2 has been sent with respect to a penalty to which this section applies,  
3 only the Chief Counsel of the Franchise Tax Board may  
4 compromise all or any portion of that penalty.

5 (B) The exercise of authority under subparagraph (A) shall be  
6 at the sole discretion of the Chief Counsel of the Franchise Tax  
7 Board and may not be delegated.

8 (C) Notwithstanding any other law or rule of law, any  
9 determination under this subdivision may not be reviewed in any  
10 administrative or judicial proceeding.

11 (d) For purposes of this section, the terms “reportable  
12 transaction” and “listed transaction” have the respective  
13 meanings given to those terms by subdivision (a) of Section  
14 18407.

15 (e) (1) In the case of an understatement (as defined in Section  
16 6662(d)(2) of the Internal Revenue Code) all of the following shall  
17 apply:

18 (A) The amount of the understatement (determined without  
19 regard to this paragraph) shall be increased by the aggregate  
20 amount of reportable transaction understatements and  
21 noneconomic substance transaction understatements for purposes  
22 of determining whether the understatement is a substantial  
23 understatement under Section 6662(d)(1) of the Internal Revenue  
24 Code.

25 (B) The addition to tax under subdivision (a) of Section 19164  
26 shall apply only to the excess of the amount of the substantial  
27 understatement (if any) after the application of subparagraph (A)  
28 over the aggregate amount of reportable transaction  
29 understatements and noneconomic substance transaction  
30 understatements.

31 (2) (A) In determining the fraud penalty imposed under  
32 subdivision (c) of Section 19164, references to an underpayment  
33 in Section 6663 of the Internal Revenue Code shall be treated as  
34 including references to a reportable transaction understatement  
35 and a noneconomic substance transaction understatement.

36 (B) This section does not apply to any portion of an  
37 understatement on which a penalty is imposed under Section  
38 19774.

39 (3) Except as provided in regulations, in no event may any tax  
40 treatment included with an amendment or supplement to a return

1 of tax be taken into account in determining the amount of any  
2 reportable transaction understatement or noneconomic substance  
3 transaction understatement, if the amendment or supplement is  
4 filed after the earlier of the date the taxpayer is first contacted by  
5 either the Secretary of the Treasury for federal income tax  
6 purposes or the Franchise Tax Board regarding the examination of  
7 the return or such other date as is specified by the Franchise Tax  
8 Board.

9 (4) For purposes of this subdivision, the term “noneconomic  
10 substance transaction understatement” has the meaning given that  
11 term by subdivision (c) of Section 19774.

12 19774. (a) If a taxpayer has a noneconomic substance  
13 transaction understatement for any taxable year, there shall be  
14 added to the tax an amount equal to 40 percent of the amount of  
15 that understatement.

16 (b) (1) Subdivision (a) shall be applied by substituting “20  
17 percent” for “40 percent” with respect to the portion of any  
18 noneconomic substance transaction understatement with respect  
19 to which the relevant facts affecting the tax treatment of the item  
20 are adequately disclosed in the return or a statement attached to the  
21 return.

22 (2) For taxable years beginning before January 1, 2003,  
23 “adequately disclosed” includes the disclosure of the tax shelter  
24 identification number on the taxpayer’s return as required by  
25 subdivision (c) of Section 18628.

26 (c) For purposes of this section:

27 (1) The term “noneconomic substance transaction  
28 understatement” means any amount which would be an  
29 understatement under paragraph (1) of subdivision (b) of Section  
30 19773 if Section 19773 were applied by taking into account items  
31 attributable to noneconomic substance transactions rather than  
32 items to which Section 19773 applies.

33 (2) A “noneconomic substance transaction” includes the  
34 disallowance of any loss, deduction or credit, or addition to income  
35 attributable to a determination that the disallowance or addition is  
36 attributable to a transaction or arrangement that lacks economic  
37 substance including a transaction or arrangement in which an  
38 entity is disregarded as lacking economic substance. A transaction  
39 shall be treated as lacking economic substance if the taxpayer does





1 not have a valid nontax California business purpose for entering  
2 into the transaction.

3 (d) (1) If the notice of proposed assessment of additional tax  
4 has been sent with respect to a penalty to which this section applies,  
5 only the Chief Counsel of the Franchise Tax Board may  
6 compromise all or any portion of that penalty.

7 (2) The exercise of authority under paragraph (1) shall be at the  
8 sole discretion of the Chief Counsel of the Franchise Tax Board  
9 and may not be delegated.

10 (3) Notwithstanding any other law or rule of law, any  
11 determination under this subdivision may not be reviewed in any  
12 administrative or judicial proceeding.

13 19777. (a) If a taxpayer has been contacted by the Franchise  
14 Tax Board regarding the use of a potentially abusive tax shelter,  
15 and has a deficiency, there shall be added to the tax an amount  
16 equal to 100 percent of the interest payable under Section 19101  
17 for the period beginning on the last date prescribed by law for the  
18 payment of that tax (determined without regard to extensions) and  
19 ending on the date the notice of proposed assessment is mailed.

20 (b) “Potentially abusive tax shelter” means:

21 (1) Any tax shelter (as defined in Section 6111 of the Internal  
22 Revenue Code) with respect to which registration is required under  
23 Section 6111 of the Internal Revenue Code.

24 (2) Any entity, investment plan or arrangement, or other plan  
25 or arrangement which is of a type that the Secretary of the Treasury  
26 or the Franchise Tax Board determines by regulations as having a  
27 potential for tax avoidance or evasion.

28 (c) The penalty imposed by this section is in addition to any  
29 other penalty imposed under Part 10 (commencing with Section  
30 17001), Part 11 (commencing with Section 23000), or this part.

31 (d) This section shall apply to notices of proposed assessments  
32 mailed after the effective date of the act adding this section.

33 19778. For any amended return filed after April 15, 2004, and  
34 before the taxpayer is contacted by the Internal Revenue Service  
35 or the Franchise Tax Board regarding a potentially abusive tax  
36 shelter, then, for taxable years beginning after December 31, 1998,  
37 with respect to any understatement of tax related to using  
38 reportable transactions as defined in Section 18407, as added by  
39 the act adding this section, the taxpayer is subject to interest as

1 provided under Section 19101 but at a rate of 150 percent of the  
2 adjusted annual rate established under Section 19521.

3 SEC. 14. Section 21028 of the Revenue and Taxation Code is  
4 amended to read:

5 21028. (a) (1) With respect to tax advice, the protections of  
6 confidentiality that apply to a communication between a client and  
7 an attorney, as set forth in Article 3 (commencing with Section  
8 950) of Chapter 4 of Division 8 of the Evidence Code, shall also  
9 apply to a communication between a taxpayer and any federally  
10 authorized tax practitioner to the extent the communication would  
11 be considered a privileged communication if it were between a  
12 client and an attorney.

13 (2) Paragraph (1) may only be asserted in any noncriminal tax  
14 matter before the Franchise Tax Board.

15 (3) For purposes of this section:

16 (A) “Federally authorized tax practitioner” means any  
17 individual who is authorized under federal law to practice before  
18 the Internal Revenue Service if the practice is subject to federal  
19 regulation under Section 330 of Title 31 of the United States Code,  
20 as provided by federal law as of January 1, 2000.

21 (B) “Tax advice” means advice given by an individual with  
22 respect to a state tax matter, which may include federal tax advice  
23 if it relates to the state tax matter. For purposes of this  
24 subparagraph, “federal tax advice” means advice given by an  
25 individual within the scope of his or her authority to practice  
26 before the federal Internal Revenue Service on noncriminal tax  
27 matters.

28 (C) “Tax shelter” means a partnership or other entity, any  
29 investment plan or arrangement, or any other plan or arrangement  
30 if a significant purpose of that partnership, entity, plan, or  
31 arrangement is the avoidance or evasion of federal income tax or  
32 the avoidance or evasion of the tax imposed under Part 10  
33 (commencing with Section 17001) or Part 11 (commencing with  
34 Section 23001).

35 (b) The privilege under subdivision (a) does not apply to any  
36 written communication between a federally authorized tax  
37 practitioner and any person, or any director, officer, employee,  
38 agent, or representative of the person, or any other person holding  
39 a capital or profits interest in the person in connection with the  
40 promotion of the direct or indirect participation of the person in

1 any tax shelter (as defined in Section 1274(b)(3)(B) of the Internal  
2 Revenue Code, as modified by subdivision (g) of Section 19164),  
3 or in any proceeding to revoke or otherwise discipline any license  
4 or right to practice by any governmental agency.

5 (c) This section shall be operative for communications made on  
6 or after the effective date of the act adding this section.

7 (d) This section shall remain in effect only until January 1,  
8 2005, and as of that date is repealed, unless a later enacted statute,  
9 that is enacted before January 1, 2005, deletes or extends that date.

10 SEC. 15. (a) Unless otherwise provided, this act shall apply  
11 with respect to any penalty assessed on or after January 1, 2004,  
12 on any return for which the statute of limitations on assessment has  
13 not expired. All other provisions of this act shall apply on and after  
14 January 1, 2004.

15 (b) Except as provided in subdivision (c), Sections 18407,  
16 19772, and 19773 of the Revenue and Taxation Code, as amended  
17 or added by this act, apply to taxable years beginning on or after  
18 January 1, 2003.

19 (c) (1) The penalty provisions of Section 19772 apply to any  
20 person that satisfies both of the following:

21 (A) The person is subject to the provisions of Sections 18407  
22 and 19772.

23 (B) The person has invested in a transaction after February 28,  
24 2000, and before January 1, 2004, where that transaction becomes  
25 a listed transaction at any time.

26 (2) (A) A person that is subject to the provisions of Section  
27 6111 of the Internal Revenue Code, as incorporated and modified  
28 by Section 18648, must register a tax shelter with the Franchise  
29 Tax Board before April 30, 2004, if that tax shelter was offered for  
30 sale between February 28, 2000, and January 1, 2004 and becomes  
31 a listed transaction on or before January 1, 2004.

32 (B) The penalty under Section 19173 applies for a failure to  
33 register the tax shelter under subparagraph (A).

34 (3) (A) Subdivision (c) of Section 18648 does not apply to  
35 licensed attorneys in the case of a transaction that was entered into  
36 before January 1, 2004, if the attorney is considered a material  
37 advisor solely due to the practice of law.

38 (B) The provisions of subparagraph (A) shall only apply to an  
39 attorney offering advice in an attorney-client relationship where:

(i) Legal advice of any kind is sought from a professional legal adviser in his or her capacity as a professional legal adviser;

(ii) The communications are made in confidence and relate to that purpose; and

(iii) The communications are made or received by the client.

(4) For purposes of applying Section 19778 of the Revenue and Taxation Code, Section 18407 of the Revenue and Taxation Code, as added by this act, applies for taxable years beginning after December 31, 1998.

SEC. 16. The Legislative Analyst, based on the information provided to it by the Franchise Tax Board and other available information, shall report to the Legislature within two years of the effective date of this act regarding the impact of the act. To the extent feasible, this report shall include observations regarding the impact of the act on tax shelters, state tax collections, and the state's business climate.

SEC. 17. This act shall become operative only if Senate Bill 614 of the 2003–04 Regular Session is chaptered.

CORRECTIONS

Text — Pages 6 and 22.